

JANUARY 2019

INTEREST RATES IN 2019 – WHICH WAY WILL THEY GO AND WHY?

“Prediction is very difficult, especially if it is about the future” (Nils Bohr – Nobel Laureate)

Normally the market and economic commentators react favourably to interest rate decisions of the Monetary Policy Committee (MPC). The Reserve Bank, which houses the MPC, is one of the most admired institutions in the country.

The MPC’s decision to raise interest rates in November however drew a sharp reaction, and polarised opinion into two camps, both with strong arguments -

What can the recent rate increase tell us? Firstly, what those against the increase said...

The economy was either in recession or close to it when the decision was announced. This is contrary to mainstream economic thought as raising interest rates tend to slow down economic growth.

Secondly, inflation at 5.1% is well within the 3-6% band that the MPC targets. If you look at Shoprite, our largest grocery chain, more than 11,500 items in their stores are trading at lower prices than this time last year. Aligned to this is that the fuel price decreased by more than R1.80 per litre in December. The petrol price spreads its tentacles widely throughout the economy and this decrease will reduce cost pressures.

Consumer confidence has been dropping in recent months and a rise in borrowing rates will not help this.

Finally, the currency has shown strong gains over the past few months and thus the Rand needs no bolstering from an increase in interest rates.

Secondly, what those for the increase said...

It helps those with high savings as they will receive more monthly income.

One key uncertainty is the oil price. It has fallen 30% but this can just as quickly reverse.

It was unknown to the general public at the time (although the MPC would probably have known about it) but the Purchase Price Index, which measures cost increases within business, jumped to 6.9%. This indicates that industry is experiencing cost pressures which will over the next few months find their way to the consumer.

The international outlook is volatile with President Trump attacking Chinese trade policies. This volatility often negatively affects developing nations (like ours) as investors tend to move their funds into secure investments such as US Treasury Bonds. Thus, increasing interest rates will help shore up the Rand.

In turn, making the Rand more stable will send a positive signal to Rating Agencies which can help stave off further downgrades. This also can help to encourage investment which is crucial to future economic growth.

If one looks at these two viewpoints, the risks pretty well balance each other out. Clearly, the MPC was cautious with this call and time will tell which side was correct.

So which way will interest rates move in 2019 and beyond?

Where are local and global interest rates going? The consensus has been that the USA will continue to gradually increase



rates as its economy has been surging. However, recent comment from the Federal Reserve Board indicates they will pause upping interest rates in 2019. **Presently our Monetary Policy Committee have planned to raise rates from 6.5% at present to 7.7% in 2019**, but these may be put on hold if the USA keeps rates constant.

Just bear in mind also that it is notoriously difficult for even the best economists to predict future economic conditions with any degree of certainty, so perhaps the best advice is to be prepared for both scenarios.

DEEMED ACCRUALS CAN SERIOUSLY DISRUPT YOUR CASH FLOW – A TAX LESSON FOR PROPERTY DEVELOPERS

A recent Supreme Court of Appeal (SCA) judgment has confirmed a view that our courts have held for a long time - namely that when a property developer enters into an agreement with a buyer to transfer the property, even if the developer only actually gets paid in a subsequent tax year, the income is deemed to have accrued to the developer at that date. The developer must therefore include the full proceeds of the sale in its income tax return for the year the agreement was signed.

This has the effect of the property developer paying tax before receiving the proceeds of the sale, putting the developer out of pocket until transfer to the purchaser takes place.



A R1.9m tax assessment challenged

A property developer in Cape Town entered into sales agreements for 25 units. Each agreement called for a deposit of R5,000 with the balance to be paid on completion of the development. Purchasers could take possession once the full sale price had been secured or within 60 days of the sale. By the end of the first year 18 purchasers had taken possession and in all 25 cases the purchase price had been fully secured.

Transfer of the properties took place in the next tax year. The developer did not include the sale proceeds in his tax return for the year of concluding the agreements but showed the proceeds in the next tax year.

The Court upheld the decision by SARS to tax the developer in full in the first tax year. The assessment at just under R1.9m was based on taxable income of R6.8m.

Why the developer lost

Property developers assume a substantial risk when they undertake a development – they spend millions of Rand upfront and if they can't sell the developed properties they make a considerable loss. They mitigate this risk by selling the properties upfront – usually before they commit to building. Clearly they will not get paid until the property is transferred, so they accept a deposit plus a guarantee (usually from the purchaser's banker) for the balance of the selling price, or alternatively the buyer placing the funds in the conveyancer's trust account.

Once the developer is assured of selling the properties it then proceeds with the development. On this basis, banks will advance the cost of the development to the developer.

However, in terms of the law the proceeds of the sale of the properties are deemed to have accrued to the developer and are taxed in the year the agreement is signed.

This principle has been upheld by our courts for generations and developers need to be aware of the cash flow implications.

WHAT IS A VALUATION WORTH? THE ART OF VALUING ASSETS AND BUSINESSES

Recently the artist Banksy put up for auction a work called “Girl with Balloon”. It was sold for GBP860,000. No sooner had it been sold than it began to shred (Banksy had put a shredder in the frame). Halfway through the shredder got stuck.

Paradoxically Girl with Red Balloon is now worth double the price it fetched.



So how do we determine value?

In the bond market and stock markets value is determined by millions of people interacting to buy bonds or stocks. Valuations thus change by the second. Analysts use a variety of methods to value, say, shares and send out notes to their clients recommending certain shares to be undervalued and thus worth acquiring. However, there is uncertainty in this.

When we decide to sell our business either our accountant or business broker will value the business. A variety of techniques are used such as discounted cash flow, net asset value, comparative analysis of business competitors etc to arrive at a value. Of course in practice your business may be sold for a higher or lower amount than the valuation.

Finally, Bitcoin got to just under \$20,000 last year but is now struggling to maintain a value of \$4,000. Its loss of nearly 80% of its value puts it in bubble territory, and as a pioneer in cryptocurrencies it is virtually impossible to value.

What does all this mean?

It should also be pointed out that the work that analysts and business brokers do is worthwhile (after all they are repeatedly asked to perform valuations), but each one of us looks at assets in our own unique way and we see value differently from the next person, illustrating how difficult it is to determine value objectively.

Valuations are in reality merely trying to establish a point whereby sellers and buyer can start to negotiate.

DIRECTORS: FIGHTING CORRUPTION VIA YOUR SOCIAL AND ETHICS COMMITTEE

“South Africa has lost R700 billion to corruption over the last 20 years” (Institute of Internal Auditors)

The Companies Act requires a company to set up a Social and Ethics Committee if it is:

- A listed company
- A state owned entity
- A company with a public interest score of over 500 in two of the last five years.



Social and Ethics Committees have a broad mandate to reduce corruption, to ensure that B-BBEE and Employment Equity Act programs are compliant with legislation, to be a good corporate citizen uplifting society around them and to ensure all employees are treated fairly and equitably.

The Companies and Intellectual Property Commission (CIPC) is empowered to issue guidelines and practice notes on aspects of the Companies Act.

The new CIPC guideline

The purpose of this guideline is to get companies to actively fight corruption and to set up a Corporate Compliance Program along the lines of the OECD (Organisation for Economic Co-operation and Development) Recommendation on corruption.

This initiative of the CIPC is a response to State Capture and to corruption scandals in the private sector. Corruption is becoming endemic in our society and can only be turned back and stopped by a comprehensive program.

The compliance program

1. The starting point is commitment from top management to instil into the culture of the company that corruption is unacceptable across the organisation. Senior management should ensure that the Compliance Program is communicated on an ongoing basis to all stakeholders.
2. A risk-based approach should be used to identify all potential corruption risks and on a continual basis manage these risks throughout the company. A database of all information gathered should be continually fed back to staff and stakeholders, and shared with other organisations fighting corruption.

All activities in the company should be undertaken with the risk management process underpinning these processes.

3. An ongoing due diligence program should verify who the company is dealing with.
4. Policies and procedures should be implemented and these should be clear-cut and easy to understand.
5. Compliance training is to be undertaken and all staff and key stakeholders included in the training.
6. Whistle blowing is to be actively encouraged and separate channels should be set up for whistle blowers to communicate any wrongdoing they become aware of. Whistleblowers need to be protected against reprisals and victimisation.
7. A high level of auditing and investigative capacity needs to be implemented. Corruption, as we know, needs to be continuously attacked until it is completely uprooted.

We are all losers when it comes to corruption, so even if your business isn't required to form a Social and Ethics Committee, consider what steps you can take to fight it.

Finally, don't just follow the law and think that is enough. Those implicated in State Capture or private sector malfeasance protest they have broken no laws. Equally important is to practise good governance by implementing transparent and ethical norms.

BE AWARE OF THE CHANGES TO VAT ON ELECTRONIC SERVICES

The Minister of Finance warned in his 2017 Budget speech that VAT on electronic services would be widened. Treasury has now published regulations that come into effect on 1 April 2019.

The major changes

The definition of "Electronic Services" has been considerably broadened to include virtually all services. There are few exclusions namely:

- Intra group transactions if the local company is a wholly-owned subsidiary of a foreign entity
- Telecommunication services



- Educational services provided by an entity regulated in a foreign country.

This means that B2B (Business to Business) transactions are included in the definition. This differs from other countries who exclude B2B and only tax B2C (Business to Consumers) transactions.

Electronic Services include cloud computing, advertising services, software subscriptions (such as anti-virus software), access to databases, the use of software provided by a foreign holding company (unless the above exclusion applies), broadcasting, and price reservation services.

Another point to consider is that intermediaries providing a platform for offshore entities are included in the Electronic Services definition. Thus a platform which invoices and collects payment on behalf of a foreign entity is included. This is sensible as it will be administratively simpler not to unnecessarily involve foreign businesses.

The threshold for businesses to register for VAT is R1 million in annual turnover from Electronic Services.

Take time to consider how this will affect your business. Better to get it right now than to have to negotiate penalties later with SARS.

It is worth speaking to your Accountant now if you could be impacted by this.

YOUR TAX DEADLINES FOR JANUARY

Provisional taxpayers who use eFiling need to submit their 2017/8 Income Tax Return on or before 31 January 2019.

You will have noticed that being registered for eFiling gives you a much later filing deadline than applies to manual submissions. If you aren't already registered and would like to be in time for the 2019 tax season, SARS suggests you "Go to [SARS eFiling](#) > click Register > follow the 7 easy steps... With [Help-You-eFile](#), help is just a click or a call away. Click the [Help-You-eFile](#) icon, accept the term and conditions and select Call Me. A SARS agent will call you and will help you every step of the way while you're eFiling..."

Ask for your accountant's help in need.

